

Memorandum



Date: January 11, 2005

To: Honorable Natacha Seijas, Chair
and Members, Infrastructure and Land Use
Committee

From: George M. Burgess
County Manager

Subject: Update to Financial Assessment of the Department of
Solid Waste Management

ILU
Agenda Item No. 1(D)2

This report substitutes the report titled, "Update to the Financial Assessment of the Department of Solid Waste Management" deferred at the December 7, 2004 Government Operations and Environment Committee. The report differs from the original in that it includes updated information prepared by the Department of Solid Waste Management (DSWM).

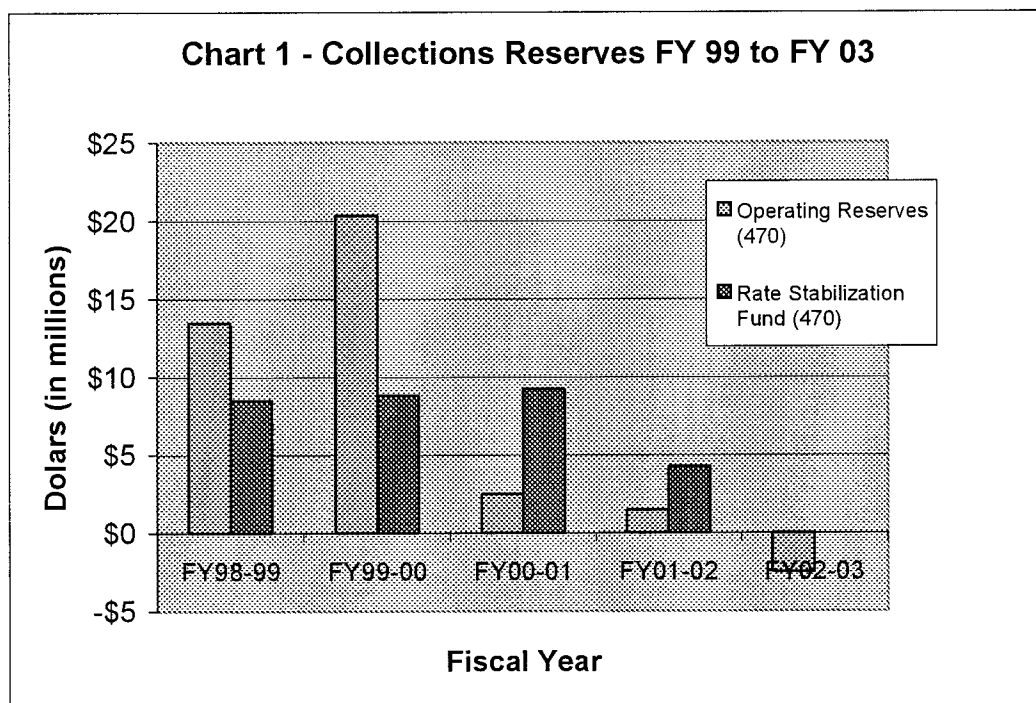
The report updates a financial presentation made to the Government Operations and Environment Committee in July, 2003 and includes a five year Outlook for the Collections Fund, supported by Waste Collection Service Area fees, and the Disposal Fund, supported by fees of a countywide nature. Because of the distinct nature of the revenues supporting each fund, neither fund can provide support to the other to fund operating expenses. Of critical note at this time, the DSWM preliminary five-year projection indicates eroding stability in the Collections Fund with a cash deficit appearing by FY 2006-07.

Background

Historically, Collection costs have risen at a rate of about six percent per year, driven by several factors including the annual inflation adjustment on disposal fees, which represent about 38 percent of the budget, inflation incorporating both merit increases and wage adjustments in accordance with the collective bargaining agreement, which represent about 34 percent of the budget, increased fuel and maintenance costs, which represent approximately 8 percent of the budget, increases in the cost of county overhead, and certain unfunded public services such as illegal dumping clean-up. Revenues, on the other hand, holding the household fee constant, have risen at a rate equal to the growth of the customer base, about two percent per year.

The growing revenue-expenditure gap has been funded with available reserves. Once these reserves were exhausted, the gap was funded with the Collections restricted rate stabilization reserve. The Collections fund was in deficit by \$2.5 million at September 30, 2003 (see Chart 1 below).

The 2003 Assessment projected debt service coverage of 85 percent where 120 percent is required with use of rate stabilization, and a minimum 100 percent without use of rate stabilization. The 2003 Assessment also recommended a household fee increase equal to the full cost of curbside collection (\$419 per household in FY 2002-03) and made further recommendations for structural reform in both funds, particularly in Trash operations. These included implementing the revised Landscaper Program, reconfiguring Trash and Recycling Center (TRC) operations, eliminating “garbage go backs”, and considering pay as you go programs in bulky operations.



Subsequently, the Board approved a revised Landscaper Program (implemented in August 2003) with an estimated annual net benefit to Collections of \$8.8 million. At the September 2003 budget hearings, the Board approved a Household Fee increase from \$349 to \$399 for FY 2003-04, which when combined with the Landscaper Program, covered \$23.2 million of a \$25 million revenue – expenditure gap necessary to close in order to balance the budget.

The Department balanced the remaining gap in the FY 2003-04 Collections Budget with the following: eliminating “garbage go backs” (\$400,000), a dumpster fee (estimated at \$1.66 million), automated garbage collection savings (\$1 million), shifting support of the illegal dumping transfer to police to the Disposal Fund (\$1.15 million), delay certain capital projects (\$200,000) and programmed an administrative savings plan (\$1.8 million); combined, these actions were projected to restore a positive fund balance of \$4 million by the end of FY 2003-04.

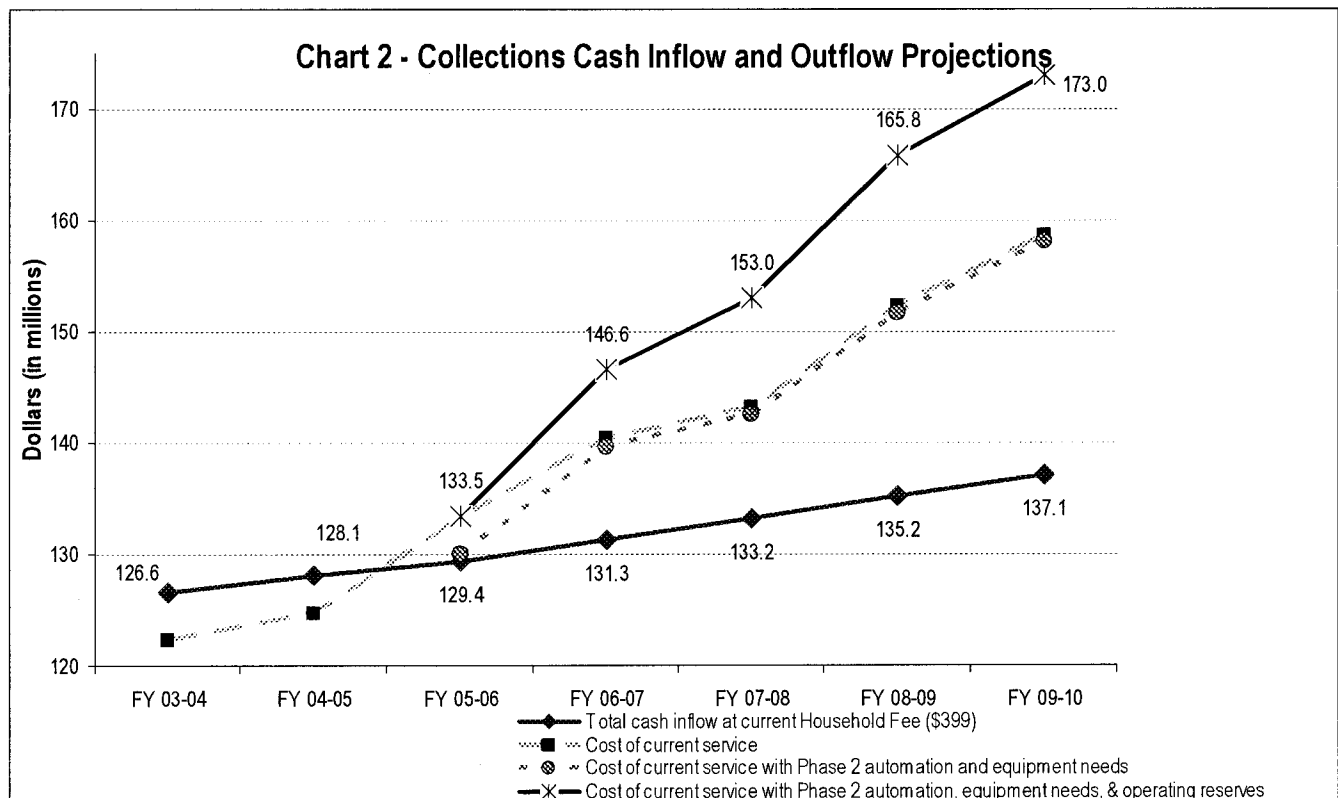
For FY 2003-04 the Department achieved 153 percent debt service coverage (preliminary) without the use of rate stabilization and is projecting a FY 2003-04 preliminary year end positive Collections fund balance of \$1.7 million versus \$4 million budgeted.

Five Year Outlook

Collection Fund

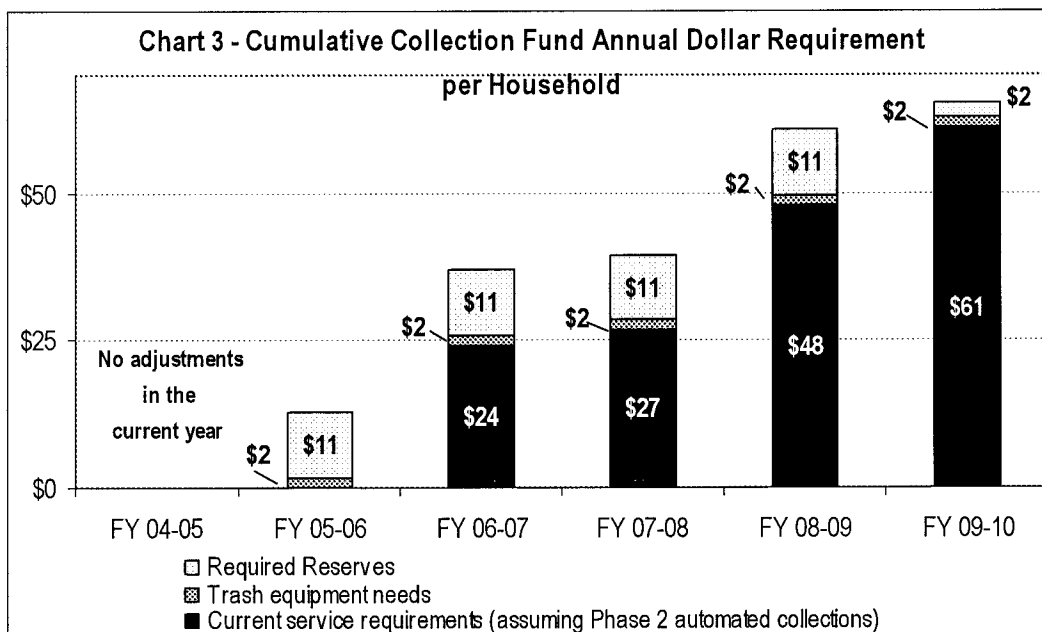
Chart Two provides preliminary, un-audited Collection cash inflows and outflows for FY 2003-04 year end as of July 2004, the FY 2004-05 Budget and for future years to 2010. The projection assumes constant inflation of 3.2 percent, wage inflation of five percent, regularly programmed capital requirements, debt service for the current automated vehicle procurement and a household fee constant at \$399. Based on these assumptions, the Collections Fund expenditures exceed projected revenues beginning in FY 2005-06, and the fund is projected to return to a cash deficit during FY 2006-07, which becomes worse by 2010. It is necessary to use the Disposal Fund to cover the required 60 day operating reserve for the Collections Fund for the entire Outlook period for bond covenant purposes.

Chart Two also provides two alternate projections representing estimated cash inflows necessary to 1) cover the full cost of service net of savings from a Phase Two automated garbage collection and debt service requirements for additional automated garbage trucks and



additional trash crane replacements, and 2) everything included in scenario 1 plus restoration of the Collection Fund two month operating reserve by 2010.

The Chart Two alternate projections representing cash inflows necessary to resolve the Collection Fund cash deficit and restore the 60 day operating expense reserve can be expressed as fee equivalents. These are presented in Chart Three and represent the additional dollars required per household customer in either the form of efficiencies, savings initiatives or fee adjustments necessary to achieve recurring annual cost reductions or revenue enhancements to restore financial stability to the Collections Fund.



Disposal Fund

Forecast Disposal Fund results shown in Chart Four covering the same period as Chart Two indicate that beyond the near term, which includes a large number of capital projects funded from operations, cash inflows will meet or exceed cash outflows.

This projection incorporates the recently amended agreement with the operator of the Resources Recovery facility. It also incorporates debt service for a \$75 million bond issuance in 2005 and a \$20 million bond issuance in 2008 in addition to current senior lien obligations. Revenue tonnage is assumed to grow modestly over the period to 1.86 million tons with an assumed inflation rate of 3.2 percent on disposal tipping fees. The Disposal Fund remains stable not primarily from growth in revenue tons received by the County into its facilities, but more as a result of the indexing of its fee structure due to inflation.

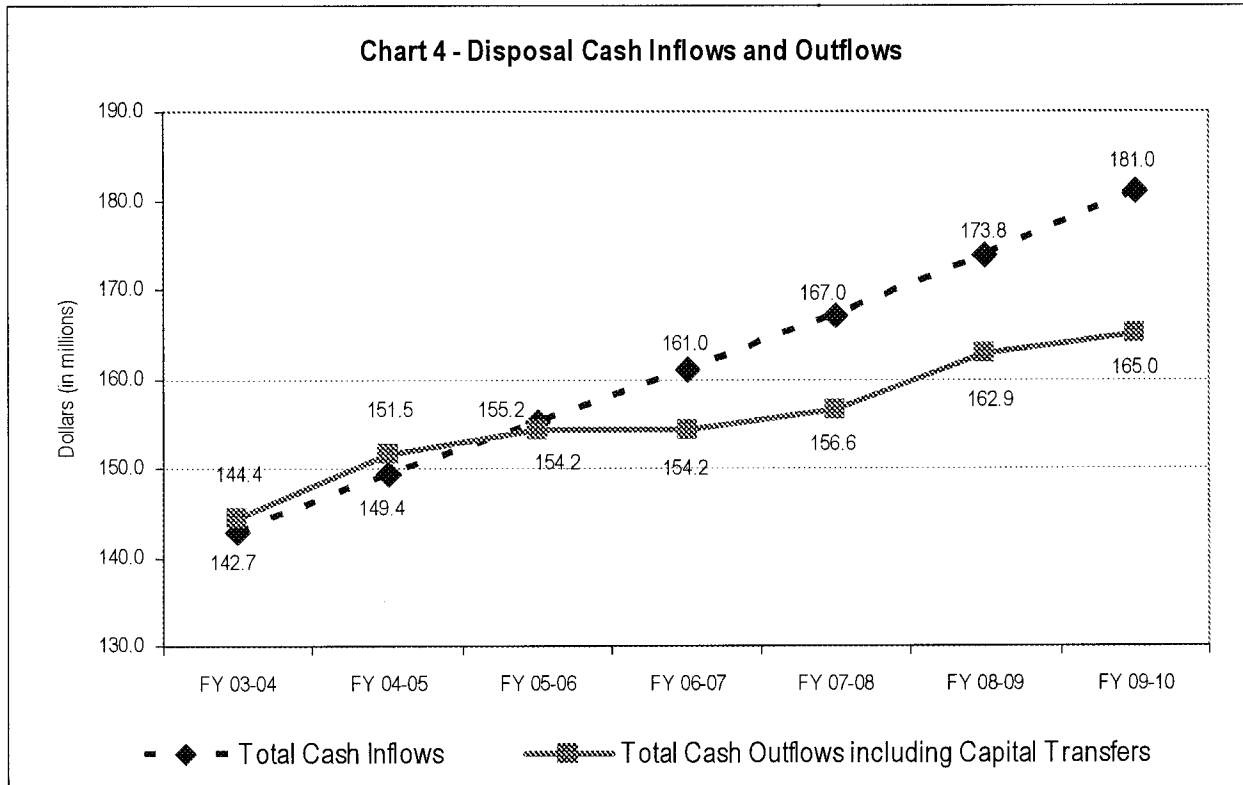


Table One summarizes the resulting net cash inflow/outflow reserve outcomes by fund, on a combined basis, and net of restricted reserve requirements.

Table One (\$ in millions): Projected Fund Balances at Fiscal year End

		2004	2005	2006	2007	2008	2009	2010
1	Collections Fund Balance	1.7	5.2	1.4	-7.6	-17.6	-34.6	-56.0
2	Disposal Fund Balance	62.6	60.7	66.0	73.2	83.6	98.0	114.0
3	Combined System Funds (row 1 + row 2)	64.3	65.9	67.4	65.6	66.0	63.4	58.0
4	60 Day Restricted Operating Reserve	31.9	32.6	33.7	35.0	36.3	37.8	39.5
5	Unrestricted Reserve (row 3 - row 4)	32.4	33.3	33.7	30.6	29.7	25.6	18.5

Note: 2004 is preliminary and un-audited

The projections conveyed in Table One indicate that the Department will be able to meet its bond covenant of a 60 day operating reserve for the period. However, combined unrestricted cash is projected to decrease to \$18.5 million over the next five years.

The Department is projected to meet its bond covenant requirement for debt service coverage including funding a massive landfill closure plan countywide. However, the strength of the coverage erodes over time (100 percent coverage is required without the use of rate stabilization fund). This indicates a need to strengthen net operating revenues over the period by either lowering costs or enhancing revenues. Table Two provides projected debt service coverage over the same period without and with the use of the rate stabilization fund.

Table Two: Projected Debt Service Coverage through Fiscal Year 2010

	2004	2005	2006	2007	2008	2009	2010
Without Rate Stabilization	153%	174%	166%	153%	143%	118%	101%
With Rate Stabilization	182%	210%	204%	194%	182%	152%	132%

Recommended Next Steps

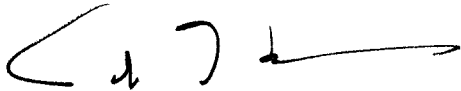
The Department faces growing financial pressure over the remainder of this decade, primarily in the Collection Fund. However, this will be met with well thought out structural reform and reasonable fee recommendations if necessary.

These include:

- Expanding automated garbage collections beyond the FY 2004-05 Phase One programmed number of households (142,500) by increasing households per existing automated route and adding new automated routes in a Phase Two program. Challenges here include the ability to finance new vehicles in the absence of Collections cash and to absorb program labor impacts each year.
- Obtaining a new curbside recycling contract in 2006 based on performance incentives that will lower per unit costs of collection, increase program satisfaction, and increase recycling revenues. Challenges here include realistic performance based contracting, processing options, and stable markets for raw recyclable material.

- Achieving reforms in trash collection by responding to growing curbside bulky trash collection demand and restructuring the existing TRC System. This year two (rather than one) centers are being recommended for closure.
- Additional trash collection reforms are recommended and could include further expanding curbside trash collection to the Department's customers and creating fewer, but larger regional TRC "super" facilities (e.g. Sunset Kendall) made part of the countywide disposal system by opening their use to all county residents on a low cost, pay as you go basis.
- Studying different pricing options for different levels of service.

Reform recommendations can be expected as part of the annual business plan process and will be brought forward to the Committee for consideration and review.



Assistant County Manager